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ABSTRACT

This guide was written to introduce consumers to home equity conversion (HEC) plans that are currently available and to explain the current state of HEC developments. It describes how the basic types of HEC plans work, gives examples of how how they can be used, discusses their advantages and disadvantages, and tells where they are available. Similarities among all HEC plans are discussed and differences between various plans are explained. Basic differences between home equity conversion plans and home equity loans are described. Special purpose loans, which do not have to be repaid until the homeowner dies, moves, or sells the house are presented as the most widely available and most often used HEC plans. Deferred payment loans for home repairs and improvements, and property tax deferral loans are described. Advantages, disadvantages, and availability of deferred payment loans and of property tax deferrals are examined. Reverse mortgages are presented as the most flexible and adaptable types of HEC plans. Three types of reverse mortgage plans are described: term reverse mortgage, split term reverse mortgage, and shared appreciation reverse mortgage. Advantages, disadvantages, and availability of each type are given. Line-of-credit reverse mortgages and insured reverse mortgages are discussed as two new forms of reverse mortgages still being developed. The final form of HEC plans presented is the sale plan and two basic types of HEC sale plans are considered: sale leaseback and the life estate. Summaries of home equity conversion plans are appended. (NB)

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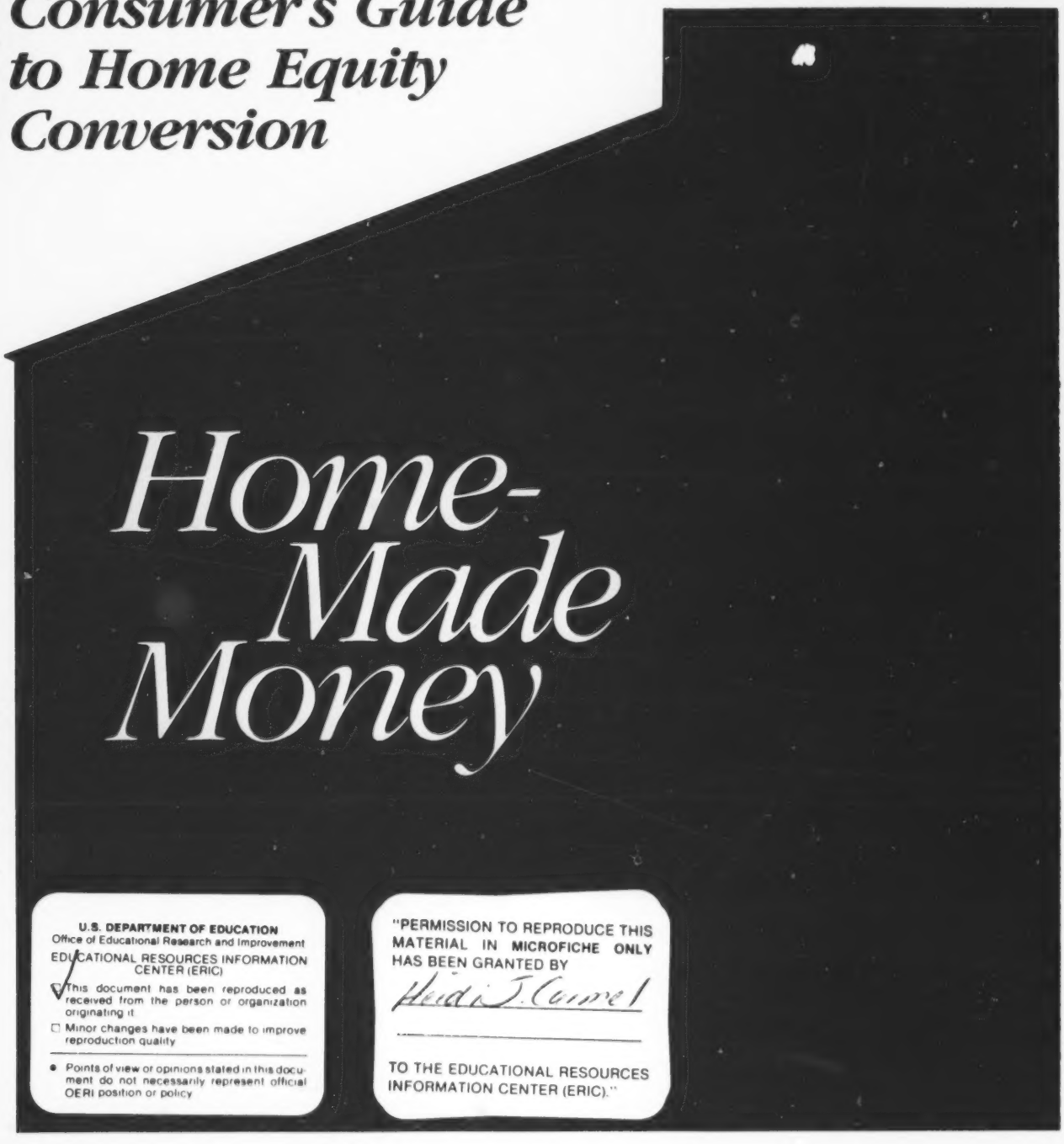
Consumer's Guide to Home Equity Conversion



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Home-Made Money

Consumer's Guide to Home Equity Conversion

by
Ken Scholen

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Foreword

It has long been the dream of many older people to be able to tap the purchasing power that lies buried in their homes.

For most, however, that has not been possible. All over this country, retirees struggle along—house rich, cash poor. To get at their home equities they have to sell their homes and rent apartments. But selling takes away one of the cornerstones of their security: a paid-for home whose carrying costs are low.

In recent years, a number of experiments have been taking place, to make it possible for retirees to use their home equities to supplement their incomes. You'll find them described in this excellent guide.

Author Ken Scholen has always been in the forefront of the home equity conversion movement—urging lenders and social agencies to adopt useful programs, as well as warning you, the consumer, about the risks in some of the lending ideas around. Here, all his work and knowledge has finally come together in a single place.

It has always been difficult to find good information on home equity programs, as I can attest from my years of writing about them. So I know that you'll find this guide enormously useful.

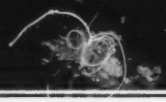
One other thing to remember: Because of the huge demand, new ideas are always popping up. AARP will continue to be a clearinghouse for home equity information, because this information is so important to its members.

It has taken a long time to establish home equity lending as a viable field. But as this guide shows, it's an idea whose time—on a large scale—is almost here.

Jane Bryant Quinn

Jane Bryant Quinn is a syndicated consumer columnist for Newsweek, *the* Washington Post *and other newspapers.*

Introduction



Getting Money from Your Home

Until recently, there were only two ways to get cash from your home. You could sell it, but then you would have to move. Or, if you qualified for a loan, you could borrow against your home. But then you would have to make monthly loan payments.

Now there are new ways of getting money from your home that do not require you to leave your home or to make regular loan payments. These "home equity conversion" plans let you turn the value of your home into cash without having to move or repay a loan each month.

Home equity conversion plans are currently available only in a limited number of areas.

Home equity conversion (HEC) plans are relatively new in the United States, although they have been available in European countries for some time. In recent years, a variety of American HEC plans have been offered in different parts of the country. These plans are still in the very early stages of development. Most are currently available only in a limited number of areas. A summary of available plans is included in Appendix A on page 00. As these plans become more widely available and new HEC plans are developed, you will probably be hearing more about them.

The purpose of this "Consumer's Guide to Home Equity Conversion" is to introduce you to the plans that are now available and to explain the current state of HEC developments. The guide describes how the basic types of HEC plans work, gives examples of how they can be used, discusses their advantages and disadvantages, and tells where they are available.

Decisions about the use of home equity are among the most important you will ever make. This guide can help you gain a better understanding of how these plans work. Whether or not they make sense for you depends on your individual situation—your goals, your resources, and your other options.

Because home equity is such an important asset, you should consider HEC plans within the larger context of your overall financial and estate planning. Several other publications on HEC that may be of interest to you and any personal or professional advisors you may have are listed at the end of this guide.

This guide can help you in several ways. If one or more HEC plans are available in your area, it can help you understand how they work and decide whether or not they fit your needs. It can also give you an understanding of future HEC opportunities that may become available to you. What you learn in these pages may help you explain your needs to attorneys, lenders, and financial planners. In some cases, individuals have played an important role in getting an HEC program started by bringing their HEC needs to professional advisors, lending institutions, and nonprofit or public agencies.

Because it is still such a new idea, HEC is not yet available in most parts of the United States. This guide tells you where each type of HEC plan is available in August of 1987. For more detailed and up-to-date information on specific HEC plans available in your area, contact AARP's Home Equity Information Center.

What Home Equity Conversion Plans Have in Common

Although they vary in design, all HEC plans are similar in several ways. A quick review of these similarities will help you understand some of the basic principles of home equity conversion.

HEC plans are generally not free. The cost to you can take any of several forms, such as application fees, closing costs, interest charges, sales commissions, or loss of future appreciation (that is, future increases in your home's value). The cost of an HEC plan can be very low or very high. In some cases, the overall cost depends on how long you live and how much your home's value changes.

The more equity you turn into cash now, the less you and your heirs will have later.

HEC plans use up your home equity. ("Home equity" means the value of your home minus any remaining mortgage or other debt against your home. For example, if your home is worth $75,000 and you still owe $5,000 on your mortgage, then you have $70,000 in home equity.) This means that the more equity you turn into cash now, the less you and your heirs will have later.

It follows, therefore, that the more equity you have, the more you can convert into cash. If you have $100,000 in home equity, you will generally be able to get twice as much benefit from an HEC plan as someone with $50,000 in home equity. Of course, if you are a renter and have no home equity, you will not be eligible for any of these plans. HEC does not create home equity; it only lets you use the equity you already have. Homeowners with a large amount of remaining mortgage debt are usually not eligible for HEC plans.

Like all financial transactions in an uncertain world, HEC plans involve some degree of risk. In some plans there is a risk that you could use up your equity and have to sell your home and move. In other plans, a fixed monthly benefit might be enough to meet your needs now, but fall short of your requirements in the future. Plans in which you give up some or all of the future growth in your home's value could end up being very costly or very generous depending on how long you live and how much your home appreciates.

There are ways to reduce, eliminate, or insure against risk. But that generally means there will be additional cost to you in the form of higher fees or lower benefits. The most important safeguard against the risks involved in HEC is to understand how the plans work and to select the plan and plan features that best meet your individual needs.

Table 1

Basic Types of Home Equity Conversion Plans

Loan Plans		
Special Purpose Loans	Reverse Mortgages (RMs)	**Sale Plans**
Deferred Payment Loan Property Tax Deferral	Term RM Split Term RM Shared Appreciation RM Line-of-Credit RM* Insured RM*	Sale Leaseback Life Estate

*Currently being developed but not yet available as of August 1987.

How Home Equity Conversion Plans Differ

The basic types of HEC plans differ from each other in several ways. Some plans are offered by private sector institutions such as banks or savings and loan associations. Other plans are provided by the public sector through state or local government agencies. Nonprofit organizations have also played important roles in developing HEC plans and in providing consumer information and counseling.

HEC plans can be categorized according to the types of benefits they provide. Some plans offer cash that can be used for any purpose you choose. Other plans—usually government programs—provide benefits that must be used for specific purposes such as paying property taxes or making home repairs.

The timing and amount of benefits is another way in which HEC plans differ. Some plans provide monthly benefits for a fixed number of years, others for as long as you remain living in your home. The monthly payments remain the same in some plans, they increase each year in others. Some plans permit you to take out a large lump sum of cash or to make irregular withdrawals from your home equity.

The most fundamental distinction among HEC plans, however, is between those in which you borrow against home equity and those in which you sell home equity. Table 1 shows the basic types of HEC loan and HEC sale plans. There are more types of loan plans than sale plans. The basic difference among the loan plans is between those that must be used in a certain way (the special purpose loans) and those that can be used for any purpose (the reverse mortgages). A more detailed summary of HEC plans is presented in Appendix A on page 00.

Home Equity Conversion Versus "Home Equity Loans"

The Home Equity Conversion plans described in this guide should not be confused with the various "home equity loans" and "home equity lines of credit" that are being widely advertised by mortgage lenders. Although both use the words "home equity," there are basic differences between HEC plans and home equity loans that are important for you to understand (see Appendix B).

There are basic differences between home equity conversion plans and 'home equity loans' that are important for you to understand.

The major difference is that you must make regular monthly payments on a home equity loan. This means that the lender will require that you have a monthly income great enough to make the payments. If your income isn't high enough, you will not qualify for the loan. On the other hand, if you do qualify and take out a home equity loan, you will have a monthly payment obligation. If you fail to make the monthly payments, the lender can foreclose on you, and you could even be forced to sell your home.

With an HEC loan plan (special purpose loan or reverse mortgage), you do not have to make monthly loan payments. This means that the lender is not looking to your income for repayment and will not disqualify you on the basis of not having enough income. Moreover, since you do not have to make monthly payments, you cannot default on an HEC loan plan due to missed payments.

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Special Purpose Loans

The most widely available and most often-used HEC plans are "special purpose loans." These loans have to be used for specific purposes such as home repairs or property tax payments. But they do not have to be repaid until you die, move, or sell your home. Special purpose loans are usually offered by government agencies or private, nonprofit organizations. In the United States there are two basic types of special purpose loans: deferred payment loans for home repairs and improvements, and property tax deferral loans.

Deferred Payment Loans

The simplest type of HEC plan is the deferred payment loan (DPL). A DPL is a loan for repairing or improving your home. There is generally no interest—or only a very low rate of interest—charged on these loans. You do not have to pay back a DPL until you die, move, or sell your home; your repayment obligation is deferred for as long as you live in your home.

DPLs are most often made by local government agencies. All such programs do not operate in exactly the same way. For example, in some programs part or all of your loan is forgiven based on the number of years you remain living in your home after you take out the loan. The longer you stay, the less you pay. Each program also has its own rules about who is eligible for the loans and what types of repairs and improvements can be made with them.

You can use DPLs for repairs and improvements that make your home safer, sounder, more accessible or usable, or more energy efficient.

In most programs, there are several eligibility requirements. Often your income and assets must be below certain levels. There may also be limits on the value or location of your home. If you have a substantial mortgage or other debt against your home, you may not qualify. In some programs there is a minimum age or a limit on multi-family dwellings.

Table 2

Differences in Home Value With and Without a Deferred Payment Loan (DPL)

Assumptions:

- Initial home value = $70,000.
- DPL = $8,000 at zero interest.
- Immediate Value Increase = $5,000.
- Annual average appreciation = 5%.

Value of Home	Without DPL	With DPL	Difference in Value
When Loan is Made	$ 70,000	$ 75,000	$5,000
After 5 Years	89,340	95,721	6,381
After 10 Years	114,023	122,167	8,144

Assuming you qualify, what could you do with a DPL? In most programs you can use it for repairs and improvements that make your home safer, sounder, more accessible or usable, or more energy efficient. As a general rule, you can use a DPL to correct physical problems or to make your home a better place for you to live. But you usually cannot use one simply to improve your home's interior or exterior appearance; that is, cosmetic changes are ordinarily not permitted.

The specific types of repairs and improvements generally allowed in DPL programs include the following: repairing or replacing a roof, stairs, floors, porches, plumbing, electrical wiring, or heating equipment; installing insulation, storm windows, weatherstripping, ramps, rails, or grab bars; widening doorways for wheelchair clearance and making other accessibility improvements.

A DPL is generally offered by a public agency at zero interest with no loan fees and no repayment required for as long as you live in your home.

Advantages. The advantages of a DPL make it a very attractive loan. It is generally offered by a public agency at zero (or very low) interest with no loan fees or "points" and with no repayment required for as long as you live in your home. The types of repairs allowed in these programs often (but not always) increase the value of your home. Improvements in kitchens and bathrooms, for example, can boost the future sales value of your property. With a zero interest loan, it is even possible that such increases plus future appreciation would be worth more than the amount owed on the loan. In other words, the loan might eventually pay for itself.

Table 2 gives an example of how this could happen. In this example, a person with a $70,000 home is considering an $8,000 DPL at zero interest to renew plumbing and improve a bathroom. The example assumes that this $8,000 investment would immediately increase the value of the home by $5,000. The table shows the future value of the home with and without the DPL at 5 percent appreciation per year.

If the homeowner does not take out the DPL, then the home's value grows to be $114,023 in ten years. But if the homeowner takes out the DPL, then the value of the home grows to be $122,167 in ten years—more than $8,000 greater than otherwise. In other words, the added value created by the DPL would be greater than the amount owed on the DPL.

Not all repairs and improvements would increase the value of a home by this amount, of course. And some improvements might even decrease a home's value. But it is possible for a DPL to be a good investment as well as a good loan.

Disadvantages. The major drawbacks to the DPL are availability and eligibility. Your local government agencies may not make such loans, and if they do you may not be eligible (see box for suggestions on tracking down DPLs in your area).

Assuming you can find and qualify for one, a DPL is one of the best loans you will ever encounter. But it is still a loan, and you need to consider whether or not you really need one. How important is the repair or improvement? Do the DPL program's rules allow you to make the type of repair or improvement you want or need? How much longer do you expect or intend to remain in your home? Would a DPL against your property make you ineligible for some other type of HEC plan that you might need in the future? If you expect your heirs to live in your home, how would they repay the DPL upon your death?

Availability. DPLs are generally made by local government agencies or by private, nonprofit organizations involved in housing or community development. To see if DPLs are available in your area, call your area agency or council on aging, the city or county housing department or authority, or your community action or community development agency. Senior citizen centers and neighborhood housing services agencies may also have information on DPLs. In some cold weather states, some gas and electric companies offer DPLs for weatherizing homes. Call the consumer affairs office or department. If you cannot find DPLs through these local agencies, call or write your state departments on aging, housing, or community development.

When you call any of these agencies, keep in mind that DPLs go by different names. Ask for information about deferred payment loans, home repair loans, or accessibility loans. Be sure to say you are interested in loans "that don't have to be repaid until you die or sell your home."

If there aren't any DPLs in your community, you may want to urge local officials to consider starting a program. A handbook for designing and operating a DPL program is listed at the end of this guide.

Property Tax Deferral

Perhaps the most widely available HEC plans in America are the various property tax deferral (PTD) programs operated by state and local governments. These programs let you borrow money from the government to pay your property taxes. You do not have to repay this money until you die, move, or sell your home. In other words, you can defer or postpone paying your property taxes for as long as you live in your home. But because your taxes are paid with the money you borrow, you are a fully paid-up taxpayer and are not tax delinquent in any way.

Although there are many important differences in how they operate, PTD programs are similar in several ways. All of them are voluntary. Each year you can decide whether or not you wish to defer that year's property taxes. All PTD programs charge interest on the money you borrow. The most common interest rates are 6 percent and 8 percent. Unlike many other loans, PTD loans generally require no loan fees or "points." But PTD programs do place a lien on your home to secure the money you are borrowing. This means that the amount of all deferred property taxes plus interest must be repaid when you move, sell your home, or when your estate is settled after your death.

PTD programs differ according to the type of agency that offers them, the manner in which the money is handled, the amount of money that can be borrowed, and the requirements for eligibility.

Some PTD programs are offered on a statewide basis with the same rules throughout the state. Other statewide plans allow local governments to make some of their own rules within state guidelines. In still other cases, PTD programs are operated on an optional basis by local governments, which means that you can participate only if your local government has decided to offer the program.

Another difference among PTD programs is in the way that money is borrowed and taxes are paid. In some state programs, you must file an application before paying your taxes. The state then sends a check directly to your local tax collector in your name, or it sends you a check made out jointly to you and your local tax collector. In other programs, you can file an application after you have paid your property taxes. In this case, you are sent a check made out to you. It is often the practice in local PTD programs to credit your property tax obligation as "paid" without issuing any check. No matter how the specific mechanics of a program operate, however, they all involve the placing of a lien against your home to secure the debt that you owe.

The amount of money that you can borrow through PTD is not the same in every program. Most programs allow you to borrow the full amount of your property taxes in any one year. But most programs also place a limit on the total amount that can be borrowed against any home. This limit is generally some percentage of your home's value or the amount of equity (value minus debt) that you have in your home.

You must be at least 65 years of age to participate in most—but not all—PTD programs. In a few programs, there is a lower age minimum or no age limit at all. Most programs also require that your income be below certain levels, but the limits generally do not exclude persons of moderate means. And in some states, eligibility is not limited by income at all. PTD programs normally restrict the amount of existing debt against a home. If you still owe a substantial amount on your mortgage or any other loan for which your home is pledged as collateral (for example, a second mortgage or home equity loan), you may not qualify for PTD.

Instead of paying your property taxes each year with cash from your pocket, you can pay from your equity when you sell your home or upon your death.

Advantages. PTD is a simple and straightforward HEC plan. Its main advantage is that it makes more cash available to you. If you choose to defer your property taxes, then you spend less of your current income on taxes and have more left to spend or save as you choose. If your annual property tax bill has been a particularly difficult one for you to pay each year, PTD offers you a new way to pay that may be more convenient. Instead of paying each year with cash from your pocket, PTD allows you to pay when you sell your home or upon your death, using the equity you have built up over many years.

PTD interest rates are generally moderate and fixed by law. You can decide each year whether or not to defer your taxes. And although you are not required to make any repayment for as long as you live in your home, you can usually make full or partial repayment at any time without penalty.

Disadvantages. PTD is available in only about one-third of the states (see box). In some of these states, the program is not available on a statewide basis and the limits on eligibility are quite restrictive.

If you defer your taxes every year, then the total amount you owe will grow each year.

If you defer your property taxes, you will have less home equity in the future than if you do not defer them. If you defer your taxes every year and make no repayment, then the total amount that you owe (deferred taxes plus interest) will grow each year. How fast your debt will grow—and how much equity you will have left—depends on the interest charged by the PTD program and the future growth in the value of your home.

Table 3 presents an example of how much you would owe if you died or sold your property after 5, 10, 15, or 20 years. The example assumes that your home is currently valued at $70,000, and that it will grow in value at a 3 percent annual rate. It also assumes that your property taxes are currently $1,200 and will increase by 5 percent per year. Finally, the example assumes that you defer the full amount of your taxes each year and make no repayment until you die or sell your home.

After five years, you would owe $6,963 at 6 percent simple interest. But your home would now be worth $81,149. So your remaining home equity (home value minus debt) would be $74,186. If 6 percent interest were charged on a compound basis, however, you would owe $7,880 and retain $73,269 in home equity. As you can see in the table, the effect of compound interest increases over time. If you remain in the program for 20 years, for example, you would owe $41,664 at 6 percent simple interest, but $70,451 at 6 percent compound interest. Your remaining equity would be $84,763 at the simple rate, but $55,976 at the compound rate. The difference between

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simple interest and compound interest can be substantial.

("Simple" interest means that interest is charged only on the money you borrow. "Compound" interest means that interest is also charged on interest previously charged but not paid. A detailed example of monthly compounding of interest is given in Table 5 on page 00.)

Differences in home appreciation rates can be significant as well. If your $70,000 home grew in value at more or less than the 3 percent rate assumed in Table 3, your remaining equity would be much different from the amounts shown in the table. For example, if a $70,000 home appreciated at only 1 percent per year, it would be worth only $85,413 in 20 years. But if it appreciated at 5 percent per year, it would grow to a value of $185,731 in 20 years—more than a $100,000 difference! If you defer your property taxes, the amount of equity that you or your heirs will have left after paying off the PTD debt will depend to a great extent on what happens to the future value of your property.

A PTD loan could limit your ability to borrow against your home for other purposes. And it could be that some other type of loan might fit your needs better. You could probably get more money each year from a reverse mortgage, but the cost would undoubtedly be greater. If you need to make a home repair or improvement, a deferred payment loan may be more appropriate.

Availability. PTD is available on a statewide basis in California, Colorado, Georgia, Illinois, Oregon, Texas, Utah, Washington, and Wisconsin. PTD is available as a local program in Connecticut, Florida, Iowa, Massachusetts, New Hampshire, Tennessee, and Virginia.

If you live in one of these states, you can generally get detailed information on the PTD in your area by contacting the local government agency to whom you normally pay your property taxes. If that agency doesn't have the information, call your area agency on aging or state department of revenue or taxation. AARP's Home Equity Information Center has general brochures on the property tax relief and property tax deferral programs available in each state.

Table 3

Home Value, Amount Owed, and Remaining Home Equity If Property Taxes Are Deferred Every Year

Assumptions:

- Initial Home Value = $70,000.
- Annual Home Appreciation = 3%.
- Initial tax bill = $1,200.
- Annual tax increase = 5%.

		6% Simple Interest Rate		6% Compound Interest Rate	
Year	Home Value	Amount Owed	Remaining Home Equity	Amount Owed	Remaining Home Equity
0	$ 70,000	0	$70,000	0	$70,000
5	81,149	6,963	74,186	7,880	73,269
10	94,074	15,850	79,224	20,602	73,472
15	109,058	27,191	81,867	40,405	68,653
20	126,427	41,664	84,763	70,451	55,976

Reverse Mortgages

The most flexible and adaptable type of HEC is the "reverse mortgage." This HEC loan plan is called a *reverse* mortgage (RM) because it works much like a standard mortgage loan, only in reverse.

When you bought your home, you probably took out a standard mortgage loan. You started with a modest downpayment, borrowed a large sum of money, bought the home, then paid back the loan in monthly installments over a number of years. Eventually, you owned the home free and clear of any mortgage, or nearly so. Your standard mortgage loan made it possible for you to acquire ownership of your home and to build up a substantial amount of home equity over the years.

A reverse mortgage makes it possible for you to convert some of your home equity into spendable cash while you retain ownership of your home.

To take out a reverse mortgage, you must already own a home free and clear of any debt, or nearly so. The RM loan is then paid out to you in monthly installments over a number of years. You are not required to pay back any of the monthly loan advances or interest until the loan term is over. At that time, you must repay all the loan advances plus interest. A reverse mortgage makes it possible for you to convert some of your home equity into spendable cash while you retain ownership of your home.

Table 4 compares a standard mortgage loan to a simple type of RM. In the standard mortgage, you purchase a $70,000 home using a $5,000 downpayment and a $65,000 mortgage loan. You pay back the $65,000 at a rate of $570.42 per month for 30 years. The total amount of all your monthly payments is $205,351 (that is, 360 payments of $570.42 each). Of this amount, $65,000 is repayment of principal and $140,351 is interest. At the end of 30 years, you own the property free and clear of any debt. The amount of home equity you now hold is $70,000 plus all increases in value (appreciation) that have occurred over the 30 years.

In Table 4's reverse mortgage example, you begin with a $70,000 home that you own free and clear of any debt. You arrange to receive monthly RM loan advances of $459.17 for seven years (this is the average loan term selected by borrowers for this type of RM). If you remain living in your home for seven years, the total amount advanced to you is $38,570 (that is, 84 monthly advances of $459.17 each). At that time, you sell your home and pay the lender $56,000 (of which $38,570 is principal and $17,430 is interest). You retain $14,000 in equity plus seven years appreciation on the home. If the property appreciates at 3 percent per year, your total remaining equity would be $30,091.

What Reverse Mortgages Have in Common

Although there are different types of RM's, they do share some common characteristics. First, all RM's are "rising-debt" loans. This means that the total amount you owe (your "loan balance") grows larger over time. When you receive your first monthly loan advance, you only owe that amount.

Because you are not obligated to pay back a reverse mortgage until some future time, your loan balance grows at an ever-increasing rate.

One month later, the lender adds one month's interest on the first loan advance to your loan balance and sends you your second monthly loan advance. One month after that, the lender adds interest on your previous month's loan balance and on the second monthly loan advance and sends you your third advance. Because you are

not obligated to pay back any of the principal advances or interest until some future time, your loan balance grows at an ever-increasing rate.

Table 5 shows how interest is charged on a typical reverse mortgage. It assumes that the monthly loan advance is $300, and the monthly interest rate is 1 percent. Each month the loan balance increases by the regular advance plus interest. Note that the monthly loan balance first increases by $303.00, then by $306.03, and then by $309.09.

Over a longer period of time, the ever-growing nature of an RM loan balance produces a substantial amount of debt. Table 5-A and Figure 1 present the amount you would owe each year on an RM that paid you $300 per month at 1 percent interest per month. After the first year you would owe $3,843—of which $3,600 would be the 12 monthly loan advances, and $243 would be interest. But after ten years you would owe almost $70,000—nearly half of which would be interest.

A second feature common to all RMs is that the amount of money that can be paid out in monthly loan advances is related to the amount of equity you have in your home, the interest rate on the loan, and the length of the loan term. In general, the more equity you have, the greater your loan advances can be. If you have $100,000 in home equity, you will ordinarily be able to get twice as much as a person with $50,000 in home equity. It is also the case that the higher the interest rate, or the longer the loan term, the smaller the loan advances can be. These relationships are explained more fully in a later section of this guide.

Table 4

Comparison of Standard Mortgage to Term Reverse Mortgage

	Standard Mortgage at 10% Interest for 30 Years	Term Reverse Mortgage at 10% Interest for 7 Years
When Loan Is Made		
Home Value	$70,000	$70,000
Homeowner's Equity*	$5,000	$70,000
Loan Terms		
Principal Advanced to Borrower	$65,000 at loan origination	$459.17 per month for seven years (= $38,570)
Repayment by Borrower	$570.42 per month for 30 years (= $205,351)	$56,000 at end of loan term
Total Interest Paid by Borrower	$140,351	$17,430
At End of Loan Term		
Homeowner's Equity	$70,000 plus 30 years of appreciation	$14,000 plus seven years of appreciation

*This comparison assumes that the standard mortgage borrower makes a $5,000 downpayment, and that the reverse mortgage borrower owns the home free and clear of any other debt.

Table 5

Increases in Loan Balances on a Reverse Mortgage Over Three Months

Assumptions:

- Monthly loan advance = $300.00.
- Compound interest rate = 1% per month.

After Month	Last Month's Loan Balance	Interest on Last Month's Loan Balance	This Month's Loan Advance	Current Loan Balance (Amount Owed)	Monthly Increase in Loan Balance
0	–	–	$300.00	$ 300.00	–
1	$300.00	$3.00	300.00	603.00	$303.00
2	603.00	6.03	300.00	909.03	306.03
3	909.03	9.09	300.00	1218.12	309.09

Table 5-A

Increases in Loan Balances on a Reverse Mortgage Over Ten Years

Assumptions:

- Monthly loan advance = $300.00.
- Compound interest rate = 1% per month.

At End Of Year	Total of Monthly Loan Advances	Interest at 1% Per Month	Loan Balance (Amount Owed)	Annual Increase in Loan Balance
1	$ 3,600	$ 243	$ 3,843	$ 3,843
2	7,200	973	8,173	4,330
3	10,800	2,252	13,052	4,879
4	14,400	4,150	18,550	5,498
5	18,000	6,746	24,746	6,196
6	21,600	10,127	31,727	6,981
7	25,200	14,394	39,594	7,867
8	28,800	19,658	48,458	8,864
9	32,400	26,046	58,446	9,988
10	36,000	33,702	69,702	11,256

A third similarity among RMs is that you can generally request that the first monthly advance be substantially larger than the rest. You can use this "initial lump sum" in most cases to pay off any existing debt against your home, to pay the closing costs or any other fees on your RM, to finance a home repair or improvement, or to use in any other way you choose.

All reverse mortgages become due and payable when you die, when you permanently move out of your home, or when you sell it. Other conditions that could require you to pay off the loan differ in detail from one plan to another. But most plans include a clause relating to long periods of time during which the home is unoccupied, such as an extended nursing home stay. Most RMs also include standard mortgage clauses relating to failure to insure, maintain, repair, or pay taxes on the home.

A fifth feature common to most RMs is that your legal obligation to pay back the loan is limited by the value of your home. This "nonrecourse" or "limitation of liability" provision means that the lender cannot require repayment from assets other than your home. A nonrecourse clause also protects your heirs and your estate against claims by the lender.

You keep the title to your home with an RM. The lender does not become an owner of your property. However, if you (or your heirs) fail to repay the loan when it becomes due, then the lender has the right to foreclose and force you to vacate the premises.

Most RMs permit you to prepay the loan at any time without penalty. This means you can decide to end the loan by repaying all principal advances plus interest before you die, move, sell the property, or reach the end of a fixed loan term that you had previously selected.

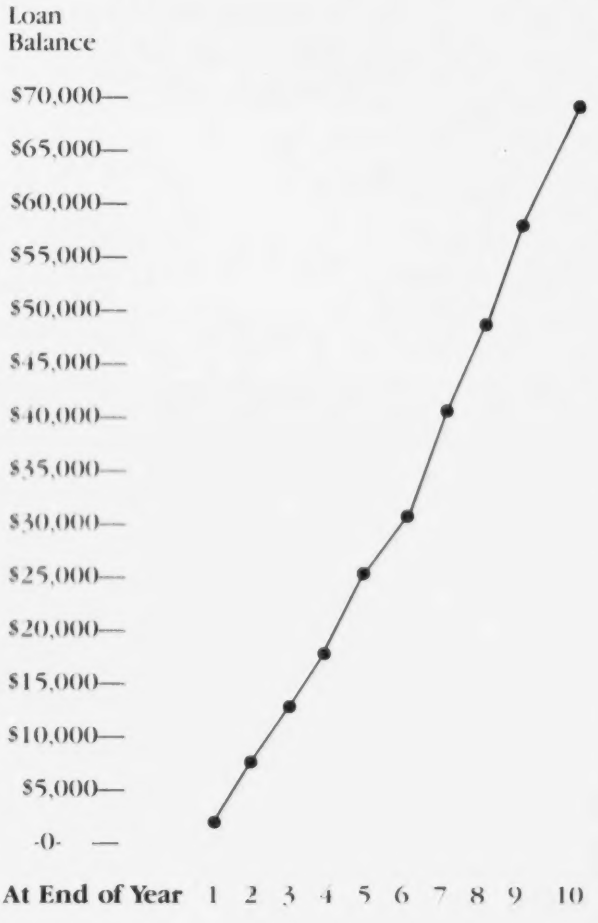
Advantages. Specific types of RMs have their own advantages and disadvantages. These are discussed later, along with more detailed explanations of different RM types. In this section, the general features of RMs are discussed.

Figure 1

The Rising Loan Balance on a Reverse Mortgage

Assumptions:

- Monthly loan advance = $300.00
- Compound interest rate = 1% per month.



An RM allows you to convert some or all of your home equity into cash while retaining ownership of your home and benefitting from some or all of the future growth in the value of your property. With an RM, you can decide how much equity you want to turn into cash and how much you want to reserve for future use or for your estate. RM advances can be used for any purpose you choose. And you can generally get more money from an RM than from either deferred payment loans or property tax deferral.

Important risks associated with reverse mortgage borrowing are different for each specific type of reverse mortgage.

The loan advances from an RM are nontaxable and do not affect your Social Security or Medicare benefits. If you receive Supplemental Security Income (SSI), RM advances do not affect your benefits or eligibility so long as you spend them within the month you receive them. This is also the case for the Medicaid program in most—but not all—states. (The amount of any RM funds you keep beyond the month in which you receive them is added to your liquid assets and may affect your eligibility for SSI or Medicaid.)

Disadvantages. All types of RMs use up some or all of your home equity, leaving less for you and your heirs in the future. The cost of most RMs is greater than the cost of special purpose loans. The interest rates are generally higher and are charged on a compound basis. Application fees, points, and other closing costs are usually higher as well. The interest on an RM is not deductible on your income taxes until you pay it, which doesn't happen until you pay off your total RM debt. And RM advances end when you sell your home or no longer occupy it as your principal residence. A lengthy nursing home stay, for example, could lead to a repayment requirement depending on the details of the RM.

Important risks associated with RM borrowing are different for each type of RM. The limited current availability of different RMs also varies considerably. These issues are discussed in later sections of this guide (pages 00–00).

Table 6

Three Types of Reverse Mortgages

	Term RM	**Split Term RM**	**Shared Appreciation RM**
Monthly loan advances are guaranteed	for a fixed term of years	for a fixed term of years	until the borrower dies, moves, or sells the home
Repayment of total loan balance is due	when loan advances stop	when the borrower dies, moves, or sells the home	when the borrower dies, moves, or sells the home
Interest charged is	compound interest at a fixed rate	compound interest at a fixed rate	compound interest at a fixed rate plus shared appreciation
Offered by	banks, savings and loan associations	state housing finance agencies	American Homestead Mortgage Corporation

How Reverse Mortgages Differ

At present, there are three basic types of RMs. (Two other varieties are currently being developed.) The three RMs now being offered are presented in Table 6; they are the "term RM," the "split term RM," and the "shared appreciation RM."

These RMs differ according to how long the monthly advances are guaranteed, when the total loan balance is due and payable, what kind of interest is charged, and by whom the RM is offered.

The term RM provides monthly loan advances for a fixed number of years that you select (usually at least three but no more than 12 years). All principal advances plus interest are due when the term of monthly loan advances is over. The split term RM also guarantees monthly loan advances for a fixed term, but repayment is deferred for as long as you live in your home. The shared appreciation RM makes monthly loan advances for as long as you live in your home, and repayment is due when you die, move or sell.

Table 7

Maximum Monthly Loan Advances on Term Reverse Mortgages

$60,000 Home ($48,000 Loan*)				
Loan Term =	5 years	7 years	9 years	11 years
At 10% interest:	$614	$393	$273	$199
At 12% interest:	581	363	246	174
At 14% interest:	550	335	221	152
$80,000 Home ($64,000 Loan*)				
Loan Term =	5 years	7 years	9 years	11 years
At 10% interest:	819	524	364	265
At 12% interest:	775	484	328	233
At 14% interest:	733	447	295	203
$100,000 Home ($80,000 Loan*)				
Loan Term =	5 years	7 years	9 years	11 years
At 10% interest:	1,024	656	471	332
At 12% interest:	969	606	410	291
At 14% interest:	917	559	369	254
$120,000 Home ($96,000 Loan*)				
Loan Term =	5 years	7 years	9 years	11 years
At 10% interest:	1,229	787	547	398
At 12% interest:	1,163	727	492	349
At 14% interest:	1,100	671	442	305

*Loan balance at end of term equals 80% of home value when loan is made.

All three plans charge a fixed rate of compound interest on the loan advances. The shared appreciation RM also charges a portion of any future increases in your home's value. The term RM has been offered by banks and savings and loan associations, the split term RM by state housing finance agencies, and the shared appreciation RM by a mortgage bank called American Homestead Mortgage Corporation, Inc.

The two new RM plans now being developed are a line-of-credit RM and an insured RM. These plans would provide greater flexibility and less risk than currently available RMs offer. Both plans are being developed by government agencies, but could lead to new offerings by private lenders. The remainder of this section discusses the three current and two developing types of RM in greater detail.

Term Reverse Mortgage

The most basic type of reverse mortgage is the "term RM." This loan is paid out to you in monthly cash advances for a fixed term (that is, for a definite number of years that you select when you first take out the loan). At the end of the loan term, monthly loan advances stop and the full amount of the loan (the total of all monthly loan advances plus interest) must be paid to the lender. Ordinarily, this requires sale of the home.

Term reverse mortgages differ from all other reverse mortgages in that they become due and payable on a specific date.

If you take out a term RM, you must select the amount of the monthly loan advance and the length of the loan term. Table 7 shows the largest monthly amount you could receive on debt-free homes valued at $60,000, $80,000, $100,000, $120,000 at loan terms ranging from five to 11 years, and at different interest rates. This table assumes that the lender would limit the total loan balance at term (that is, the amount due when the monthly loan advances stop) to 80 percent of your home's current value. If your home is worth $100,000, for example, then the total amount due at term would be 80 percent of that amount or $80,000.

Table 7 clearly demonstrates three basic features of a term RM. First, the amount you can get from an RM depends on the value of your home. Note in the table that the maximum monthly advances for a $120,000 home are twice as much as those for a $60,000 home. Second, when interest rates are higher, loan advances must be lower. For example, the maximum monthly loan advance on a five-year RM assuming an $80,000 home and 10 percent interest is $819. But it drops to $733 with a 14 percent interest rate.

The length of the loan term has a dramatic impact on the maximum amount of the monthly loan advance.

Third, and perhaps most important, the length of the loan term has a dramatic impact on the maximum amount of the monthly loan advance. On an $80,000 home at 10 percent interest, for example, you can get as much as $819 per month with a five-year term, but only $265 per month with an 11-year term. There are two reasons for the drop in advances. First, you are spreading the same amount of equity out over a longer period of time. Second, the longer the loan term, the more substantial the effect of compound interest will be. On the five-year RM, you would receive more than $49,000 in principal advances and pay nearly $15,000 in interest. But on the 11-year RM, you would receive roughly $35,000 in principal advances and pay nearly $30,000 in interest.

Term RMs differ from all other RMs in that they became due and payable on a specific date (or when you die, move, or sell, if any of these events occur before the end of the loan term). If you do not pay off the loan when it becomes due, the lender has the right to foreclose on you, forcing you to move. For this reason it is very important to be cautious when considering this type of loan and to be certain that it meets your needs.

These loans are best suited for people who need more monthly income for a limited and definite period of time, and who intend or expect to sell their homes when that period is over. These loans are not well-suited for persons with a long-term of indefinite need for monthly income, or for persons who intend or expect to remain living in their homes for a long or indefinite period of time.

These loans are best suited for people who need more monthly income for a limited and definite period of time and who intend or expect to sell their homes when that time period is over.

If you consider taking out a term RM, you need to think about four basic issues: how much money you need each month, how many years you need the money, how you will repay the loan when it comes due, and how much remaining equity you will need after paying off the loan. You also need to keep in mind that each of these issues is related to the others.

Table 8 presents four examples of how a term RM on an $80,000 home might be structured to meet different types of needs. In loans A and B, the borrowers both select a four-year term—but for different reasons. Borrower A is a recently widowed woman who no longer has the benefit of a modest pension her husband received while he was living. Sometime within the coming year or two, she plans to put her home up for sale, move in with her sister, and find a part-time job. In the meantime, she needs about $300 more per month for everyday living expenses. Her term RM tides her over while she makes a major life transition. Without the RM, she might find it necessary to sell the home before she is ready to do so or to accept a lower price than she might otherwise get. The RM gives her the economic peace of mind and the time to adjust to a new period in her life.

Borrower B is very frail and ill. Her doctors do not expect her to live much more than a year. She has a strong desire to spend her remaining time in

Table 8

Four Different Term Reverse Mortgages on an $80,000 Home at 10% Interest

	Loan A	Loan B	Loan C	Loan D
Loan Term	4 years	4 years	8 years	8 years
Monthly Advance	$300	$1,000	$300	$400
Total of Monthly Advances	$14,400	$48,000	$28,800	$38,400
Total Interest	3,364	11,212	15,420	20,560
Maximum Loan Balance at Term	17,764	59,212	44,220	58,960
Remaining Equity at Term with				
0% Appreciation	$62,236	$20,788	$35,780	$21,040
3% Appreciation	72,277	30,829	57,122	42,382
6% Appreciation	83,234	41,786	83,288	68,548

her own home. To do so, however, she needs in-home help that costs nearly $1,000 per month more than she can currently afford. A term RM is her alternative to selling her home and moving to a nursing home or apartment.

Both borrowers A and B select conservative loan terms (four years) that exceed the time they expect to need the monthly RM advances. They are planning or expecting to pay off the RM before the end of the loan term. The actual amount of equity remaining in the home at expected loan payoff, therefore, is likely to be greater than the amounts listed in Table 8.

If borrower A remains in her home longer than she currently plans and sells it just as the four-year RM ends, she will still have $62,236 in remaining equity even if her home does not appreciate at all during that time. If—as she plans—she sells the home within a year or two, and if—as she expects—the home appreciates any at all, then she will have more than that amount to start a new chapter in her life.

Borrower B is less concerned about preserving equity and more concerned about using the equity she has to spend her remaining months in her own home. If she lives well beyond medical expectations and remains in her home until the end of the loan term, she will have $20,788 in remaining equity if there is no property appreciation. If the home's value grows at 3 percent or 6 percent per year, then the remaining equity will be $30,829 or $41,786 respectively.

Borrowers C and D each select a longer loan term—eight years. Both are in their late seventies and plan to remain in their homes for another four to six years. Each is on a waiting list for an apartment in a congregate housing facility, and neither wants to move until the apartment is available.

In the meantime, each needs a monthly income supplement. Borrower C selects $300 per month and borrower D selects $400 per month. Borrower C's income needs are more modest, and she wants to preserve more equity for the future. Borrower D's current needs are somewhat greater, and he is more optimistic that the wait for the apartment will be closer to four than to six years. He also lives in an area that is experiencing much more property appreciation than borrower C's area.

Advantages. These brief examples demonstrate some of the advantages of the term RM. First, it provides a fixed amount of cash each month for a fixed number of years. Second, it is a flexible loan than can be adapted to fit a variety of situations and circumstances. Third, for persons with short-term but substantial cash needs, the term RM can provide a greater monthly advance than other types of RMs. Fourth, the borrower retains the benefit of all future appreciation.

Most term RMs are offered by private lending institutions such as banks or savings and loan associations. But often a local nonprofit or public agency provides independent information and counseling services to interested consumers. These services are usually free of charge and offer comprehensive information on a variety of later life planning options in addition to home equity conversion.

Disadvantages. The most important drawback to a term RM is that it must be repaid by a specific date. It carries the risk, therefore, that you could reach the end of your loan term and wish to remain living in your home. If there is sufficient equity remaining in your home at that point, the lender may be willing to extend your loan into the future. But the lender is under no obligation to do so and does have the right to demand repayment in full. If you are unable to repay the loan, you will most likely have to sell your home and move.

This risk can be reduced by using term RM's only for term income needs, by selecting a loan term that exceeds the term of your expected needs, and by preserving sufficient equity (plus any home appreciation) for anticipated post-RM needs. But circumstances and expectations can change, and the best laid plans can go awry. A term RM could lead to a difficult financial situation or the loss of your home.

Availability. At present, term RMs are available throughout Connecticut, Massachusetts, and New Jersey, and in most parts of California. They are also offered in Pima County (Tucson), Arizona; Richmond, Indiana; Minneapolis-St. Paul, Minnesota; Nassau and Suffolk Counties, New York; and Madison and Milwaukee, Wisconsin.

Split Term Reverse Mortgage

The "split term" RM is currently available in only two states, Connecticut and Rhode Island. But it represents an important step in the development of the RM, and it may become available in other states in the future.

This loan is called a *split* term RM because the term of monthly advances is different from the repayment term. Loan advances are guaranteed for a fixed term of years and are scheduled to stop on a specific date. But loan repayment is not required when the term of advances ends. Repayment of all principal advances plus interest is not required until you die, move, or sell your home. This means you could remain in your home long past the end of the term of monthly advances. Unlike the simple term RM (in which the term of loan advances and the term until repayment is the same), the term of this RM is "split" into two parts: a fixed

Table 9

Split Term Reverse Mortgage: Features of First Two Programs

Feature	Connecticut	Rhode Island
Monthly Advance Guaranteed for	10 years	10, 15, or 20 years
Repayment Due Upon	death, sale, or move-out	death, sale or move-out
Maximum Loan Balance	$100,000 or 80% of home value, whichever is less	$60,000 or 80% of home value, whichever is less
Interest Rate	7% fixed interest	7% fixed interest
Monthly Advances	increase by 3% each year	remain the same throughout
Minimum Age	65	68
Maximum Income	household income limits vary by county and range from $13,150 to $21,550	$15,900 if single, $18,150 if married or joint borrowers

term of loan advances and an open-ended term until repayment is due.

The split term RM was developed and first offered by the Connecticut Housing Finance Agency. A similar program is now being operated by the Rhode Island Housing and Mortgage Finance Corporation. The programs are provided in partnership with the state offices on aging in each state.

The differences between the Connecticut (CT) and Rhode Island (RI) programs suggest some of the variety of specific features that can be incorporated into such programs. Table 9 presents key features of the CT and RI plans. In the CT program, the term of loan advances is always ten years, whereas RI borrowers can select a term of 10, 15, or 20 years. The maximum loan balance is $100,000 in CT and $60,000 in RI (or, in both cases, 80 percent of your home's value, whichever is less). Both programs currently charge a fixed rate of 7 percent interest on the loan advances.

The main advantage of the split term reverse mortgage over the term reverse mortgage is that repayment is deferred until you die or sell your home.

A unique feature of the CT plan is its "graduated" monthly advances. Each year the monthly cash payments you receive increase by 3 percent over the monthly amount you received in the previous year. This means that the loan advances start at a lower amount and end at a higher amount than would otherwise be the case. For example, a ten-year RM on a $75,000 home would produce a fixed monthly advance of approximately $345 in the RI program. But in the CT plan, the monthly advance in the first year would be about $300 and would increase at 3 percent per year to reach roughly $390 by the tenth year.

Advantages. The main advantage of the split term RM over the term RM is that repayment is deferred until you die, move, or sell your home.

Depending on the amount your home appreciates during the term of loan advances (and the future financial condition of the RM program), you may be eligible to receive monthly advances past the end of the scheduled loan advance term—although this is not guaranteed by either program.

The state-operated RM programs in Connecticut and Rhode Island offer very moderate interest rates. They also provide individualized information and counseling services by agencies that are familiar with the full range of later life planning options.

Disadvantages. As offered in Connecticut and Rhode Island, split term RMs are less flexible than simple term RMs. The term of loan advances in CT must be 10 years, in RI it must be either 10, 15, or 20 years. This means that you cannot get the higher monthly advances that are possible with shorter term RMs. In CT, your monthly advances must increase by 3 percent per year and, consequently, begin at a lower level than would otherwise be the case.

To be eligible for either program, your income must be below certain amounts. In CT, the maximum household income varies by county and ranges from $13,150 to $21,550. In RI, the maximum income is $15,900 for a single borrower and $18,150 for a couple or other joint borrowers.

Availability. A split term RM program could be established by most state housing finance or mortgage agencies. The CT and RI programs are both rather new, and other state agencies are looking at how they are working. Sources of more information on the design of these programs and technical assistance on their development are listed at the back of this guide.

Shared Appreciation Reverse Mortgage

The "shared appreciation" RM is the only RM that provides monthly loan advances for as long as you live in your home and defers all repayment until

you die, move, or sell. In exchange for this open-ended income guarantee, the borrower agrees to pay the lender an amount of money equal to some or all of the future appreciation in the home's value. This "appreciation sharing" is in addition to the fixed rate of interest charged on the monthly loan advances. It compensates the lender for taking the risk that you could live so long and your home appreciate so little that your loan balance would otherwise exceed your home's value.

The shared appreciation RM is the only RM that provides monthly loan advances for as long as you live in your home and defers repayment until you die, move, or sell.

Before the loan is made, you decide what percentage of future appreciation you will pay to the lender when the loan is over. The greater the percentage you select, the higher your monthly loan advance will be. Other factors that determine the amount of your loan advance are shown in Table 10. The largest advances are paid to the oldest single borrowers with the highest home values. Table 11 gives examples of the monthly advances now being paid on shared appreciation RMs to single borrowers of various ages living in homes of various values. Married couples or other joint owners borrowing under the same conditions would get less.

These examples are based on the Individual Reverse Mortgage Account (IRMA)™, the nation's first—and thus far only—shared appreciation RM. The analysis in the remainder of this section is also based on the details of this specific plan.

No matter how long you live and how much total money you receive from this RM, the total amount you owe is always limited by the value of your home. For example, if you live in your home for another 20 years and your home value increases very little or not at all during that time, then the total amount of all principal advances you will receive plus the interest you will owe may be greater than the value of your home. Nonetheless, the total amount you owe is always limited to 94 percent of your home's value. The 6 percent difference is designed to leave you or

Table 10

Factors Affecting the Monthly Advance on a Shared Appreciation Reverse Mortgage*

Factor	Higher Advances	Lower Advances
Age of Borrower	older age	younger age
Number of Borrowers	single borrower	married or joint borrowers
Value of Home	higher value	lower value
Appreciation Share Paid to Lender	higher share	lower share

*Adapted from "A Financial Guide to the Individual Reverse Mortgage Account," National Center for Home Equity Conversion, Madison, Wisconsin.

your heirs sufficient equity to cover the costs of selling your home.

If the amount of money you need each month is less than the amount the lender is willing to pay, you can choose to take a smaller monthly payment and preserve some of your equity in two ways. One way is to reduce the percentage of future appreciation you agree to pay the lender. The minimum appreciation share allowed is 20 percent.

The other way to preserve equity is to limit the amount of your current home value that you wish to convert into cash. In other words, you can choose to exempt a fixed amount of your home equity from the transaction altogether. This would reduce your monthly advance, but it would also ensure that you and your heirs always retain a certain amount of home equity in addition to the 6 percent discussed earlier.

The only shared appreciation RM that has been offered to date includes other features that you should know about. One clause in this RM contract limits the total amount of appreciation you must pay the lender if home appreciation rates are very high. Specifically, if your home's value

Table 11

Examples of Monthly Advances on a Shared Appreciation Reverse Mortgage

Assumptions:

- Borrower is single.
- Annual percentage rate (APR) of interest on loan advances is 12.1%.

A) Monthly Advance When Borrower Pays 70% of Future Appreciation

Age of Borrower	Home Value = $60,000	$80,000	$100,000	$120,000	$140,000
70	$163	$228	$292	$356	$421
75	211	286	365	443	525
80	308	411	523	635	752*
85	392	537	682	827*	972*

B) Monthly Advance When Borrower Pays All Future Appreciation

Age of Borrower	Home Value = $60,000	$80,000	$100,000	$120,000	$140,000
70	$228	$313	$399	$484	$570
75	286	391	496	602	707
80	411	561	710	860	1010
85	537	730	924	1119*	1313*

*A policy of the company offering this RM ordinarily restricts payments to a maximum of $1000 (and reduces the appreciation share or equity converted accordingly). Advances exceeding $1000 shown above are the absolute maximums available in cases in which the $1000 restriction is waived.

grows at an average annual rate greater than 15 percent per year, the lender's appreciation share is limited to an annual rate of 15 percent. This "hyper-inflation" safeguard reduces—but does not eliminate—the likelihood of high borrower costs due to extraordinary rates of home appreciation.

Another contract clause protects you against default by the lender. This safeguard provides a severe penalty if the lender fails to send you your monthly advances. Specifically, the lender loses all interest and appreciation if the contractual obligation to provide monthly advances for as long as you live in your home is not fulfilled. In a case of lender default, you would not owe any interest or appreciation and would not have to pay back the monthly advances until you die, move, or sell.

The total cost of a shared appreciation RM depends on how long you remain living in your home and how much your home value changes during that time. If you live in your home for a short time and your home appreciates a great deal, then the loan will be very costly. But if you remain in your home for a long time and your home appreciates very little, then you could get your loan at a "bargain" rate.

Assume, for example, that you are a 75-year-old single borrower with a home valued at $70,000. If you agree to pay all future appreciation to the lender, you would get a monthly advance of $338 for as long as you live in your home. The total amount of interest and appreciation you would eventually pay on this loan would depend on how

Table 12

The Effective Annual Interest Rate on a Shared Appreciation Reverse Mortgage*

Assumptions:

- Borrower is single and 75 years old.
- Initial home value is $70,000.
- Annual percentage rate (APR) of interest on loan advances is 12.1%.
- Borrower pays all future appreciation to lender.
- Monthly advance to borrower is $338.

	Future A	Future B	Future C
Loan Term	3 years	12 years	24 years
Annual Average Appreciation Rate	8%	4%	2%
Home Value at End of Loan	$88,180	$112,072	$112,591
Total of Monthly Loan Advances	$12,168	$48,672	$97,344
Interest on Monthly Loan Advances	2,419	56,330	422,298
Appreciation Share at 100%	18,180	42,072	42,591
Total of Advances, Interest, and Appreciation Share	$32,767	$147,074	$562,233
94% of Home Value at End of Loan	$82,889	$105,348	$105,836
Total Amount Owed	$32,767	$105,348	$105,836
Effective Annual Interest Rate*	76.2%	12.2%	0.7%

*See explanatory note at bottom of page 00.

long you live in your home and how much your home value changes.

Table 12 displays what would happen under three different sets of future developments. In future A, you would remain living in your home until age 78 (three years) and your home would appreciate at 8 percent per year. At the end of three years, you would owe a total of $32,767 and the "effective annual interest rate"* on your loan would be 76.2 percent. In future B, you would remain in your home until age 87 and your home's value would grow at 4 percent per year. In this case, you would owe $105,348. But the effective annual interest rate on your loan would be a more moderate 12.2 percent. If, on the other hand, you lived in your home until age 99 and your home appreciated at 2 percent per year (future C), then you would owe only a little more, $105,836. And the effective annual interest rate on your loan would be less than one percent.

You would owe approximately $105,000 in futures B and C because that is 94 percent of the future value of your home. In future C, that amount is roughly $456,000 less than the total of all loan advances, interest, and appreciation sharing. Clearly, the lender would earn very little on this loan. But there will be relatively few of these 24-year loans to 75-year-olds, and low lender earnings will be offset by much greater earnings on other loans (for example, the 76.2 percent effective annual interest rate earned on a three-year loan in Table 12). This "risk-pooling" approach is what allows the lender to guarantee advances for as long as you live in your home. Borrowers who live a long time or whose homes appreciate little are, in effect, subsidized by borrowers who live a short time or whose homes appreciate a lot.

A shared appreciation RM can be very costly if used on a short-term or limited-term basis.

As you can see, the cost of a shared appreciation RM can vary greatly, and the actual cost can only be known when the loan is over. The obvious lesson to be learned from this analysis is that a shared appreciation RM can be very costly if used on a short-term basis. If you know you need RM advances for a short or fairly definite period of time, then a term RM would be better suited to your needs.

Taking out a shared appreciation RM is somewhat similar to buying certain annuities or life insurance policies. The benefits of some of these products are not known when you buy them. If you buy a single premium annuity with neither a refund feature nor a death benefit (to get the highest possible payment), then you would have a very high cost if you die within a short period of time. On the other hand, if you pay term life insurance premiums for several decades and live beyond the point of insurance coverage, you would be paying much but receiving no cash benefit in return.

In both cases, however, what you would be buying is the guarantee—if you live a long time (with the annuity) or if you live a short time (with the term insurance), you (or your heirs) would reap substantial financial benefits. Risk coverage is also a primary feature of the shared appreciation RM. You are not only paying interest on a loan, you are also buying the guarantee that you will receive monthly advances for as long as you live in your home, even if your home appreciates very little. This risk coverage can be very expensive if you remain living in your home a short time and your home appreciates substantially. But the cost comes down the longer you live in your home.

*One way to look at the cost of a shared appreciation RM is to combine the total dollar amount of interest on the monthly loan advances with the total dollar amount of the appreciation share—and then calculate what single annual rate of interest charged on the loan advances would produce that combined total dollar amount. In other words, the "effective annual interest rate" is the single rate that would have to be charged on the loan advances over the term of the loan to produce the same total dollar amount of interest plus appreciation that you would owe on the loan when you die or sell your home. The effective annual interest rate calculations in this discussion do not include closing costs or loan fees.

A more complete picture of the effect of loan terms and appreciation rates on the effective annual interest rate paid on a shared appreciation RM is presented in Table 13. This table is based on a 75-year-old single borrower who agrees to pay all future appreciation on a $100,000 home to the lender. It shows an overall pattern of higher effective interest rates for shorter term loans and higher rates of appreciation, and lower effective interest rates for longer term loans and lower rates of appreciation.

Advantages. The most important advantage of the shared appreciation RM is the guarantee of monthly advances—and no repayment required—for as long as you live in your home. This is the only RM that provides this degree of income security. The shared appreciation RM is also flexible. You can decide how much of your current home equity to include in the mortgage and how much of the future appreciation will be paid to the lender. In this way you can select the balance between equity converted to cash versus equity preserved

Table 13

The Effective Annual Interest Rate on a Shared Appreciation Reverse Mortgage at Various Appreciation Rates and Loan Terms***

Assumptions:

- Borrower is single and 75 years old.
- Initial home value is $100,000.
- Annual percentage rate (APR) of interest on loan advances is 12.1%.
- Borrower pays all future appreciation to lender.
- Monthly advance to borrower is $496.
- Appreciation rates are annual averages during loan term.

Effective Annual Interest Rate

Loan Term	0% Appreciation	5% Appreciation	10% Appreciation
3 years	12.1%	53.9%	88.9%
6 years	12.1	29.1	43.6
9 years	12.1	21.3	30.2
12 years	4.5	13.6	21.9
15 years	0.7	9.8	17.9
18 years	−1.5	7.8	15.7
21 years	−2.9	6.5	14.3
24 years	−3.8	5.8	13.4

*See explanatory note at bottom of page 00.

**Adapted from "A Financial Guide to the Individual Reverse Mortgage Account," National Center for Home Equity Conversion, Madison, Wisconsin.

for future use that best fits your needs. The only shared appreciation RM currently available contains important safeguards including a lender default clause and limits on both your loan balance and the amount of appreciation the lender may receive.

Disadvantages. Because of its potentially high costs over a short loan term, the shared appreciation RM is generally not a good choice if you have a short-term or relatively fixed-term need for cash. If you live in an area with high rates of home appreciation, the combined APR on this loan can easily exceed 50 percent or even 100 percent on a short-term loan.

If you convert all of your home equity and pay all future appreciation to the lender, then the amount of equity you have remaining in your home will decrease more quickly.

If you decide to take the highest possible monthly advance by converting all of your home equity and paying all future appreciation to the lender, then the amount of equity you have remaining in your home will decrease more quickly than otherwise. For example, the loan balance of a 70-year-old borrower with a $100,000 home who chooses the highest possible monthly advance would reach 94 percent of home value in ten years. At 50 percent appreciation sharing (and a lower monthly advance), the borrower would retain nearly $90,000 in home equity after ten years if the home appreciates at 5 percent per year.

The amount of remaining equity can be critically important if your plans or circumstances change. Perhaps you will decide to move or find it necessary to do so. In that case, the amount of equity remaining in your home could play a major role in helping you adjust to a new situation.

Measuring changes in property value can be difficult and could lead to disputes between you and the lender. Moreover, any property improvements you make that increase the value of your home will also increase the amount of appreciation you will owe the lender.

As you have seen throughout this discussion, the shared appreciation RM is a fairly complex financial product. This means that you need to invest a good deal of time and effort to become an informed consumer and to make decisions that are right for you. A publication with a more detailed analysis of the shared appreciation RM is listed at the back of this guide. In addition, AARP's "Consumer Housing Information Service for Seniors" (CHISS) program is currently available in three (and soon will be available in four) of the five states where shared appreciation RMs are now being offered.

Availability. The Individual Reverse Mortgage Account (IRMA)™ is the only shared appreciation RM currently available in the United States. It was developed by American Homestead Mortgage Corporation of Mount Laurel, New Jersey. The plan is now being offered in Connecticut, Maryland, New Jersey, Ohio, and Pennsylvania. American Homestead expects to expand into selected other states in the future.

Line-of-Credit RM

Perhaps you are not interested in increasing your monthly income. Perhaps your current income is adequate to meet your needs most of the time. Perhaps your greatest financial worry is the roof that will need repairing or replacing one of these years, or that gift you'd like to give, or the trip you'd like to take. Perhaps you are concerned about someday needing to pay for in-home health care or other help with the tasks of daily living. If you would like the security of knowing you could pay for these types of "now and again" or "once in a while" expenses, then a new RM now being developed—but not yet available—may be of interest to you.

A "line-of-credit" RM would work like a revolving credit plan offered by many banks, department stores, and credit card companies—but with an important difference. On a department store or credit card account, or on a "home equity line of credit," you must make monthly repayments. And, with your home as collateral for the loan, the lender can foreclose on you, and you could lose your home.

The line-of-credit RM is particularly promising because it allows you to use your home equity as you need it.

But with a line-of-credit RM you need not make any repayment of principal or interest until you die, move, or sell your home. In one specific plan now being developed by the Virginia Housing Development Authority, the amount of money you could withdraw using your line-of-credit would be limited in several ways. First, you could only make a certain number of withdrawals per year. Second, the amount you could withdraw at any one time would be limited. And third, the total cumulative amount you could withdraw (that is, the total of all withdrawals you make) would also be limited. This total limit would be related to the value of your home, and it would probably increase as you get older. Although none of the details of the VHDA proposal have been finalized, it is likely that any line-of-credit RM would have withdrawal limits of this kind.

Advantages. The line-of-credit RM is a particularly promising type of RM because it allows you to use your home equity as you need it. Many people who can make ends meet on a regular basis run into unexpected or irregular expenses that are more difficult to meet. The flexibility of the line-of-credit RM is well suited to these types of expenses.

For example, you could withdraw $2,000 for a new roof this year, and then not use the line-of-credit at all for the next several years. Later on, a health problem might put you in the market for some home health care equipment or some in-home help for a period of time. So long as your cash needs were within the program's withdrawal limits, you could finance these expenses and make no repayment for as long as you live in your home.

The flexibility of a line-of-credit RM makes your home equity somewhat like a savings account. Your decisions to spend it or to keep it would determine whether or not you would get the best use of your home equity savings. Unlike other RMs, you would not be required to use up your home equity according to a fixed schedule of withdrawals.

Disadvantages. The flexibility of a line-of-credit requires more active, ongoing management and decision making on your part than other types of home equity conversion. Once you have signed up for a line-of-credit, you must decide how often to use it and how much to withdraw. The program's withdrawal limits would keep you from taking out too much equity. But you would have to choose between using some of your equity now or preserving it for the future.

Availability. The line-of-credit RM being developed by the Virginia Housing Development Authority will probably be offered to residents of Virginia in late 1987 or early 1988. Maryland's Department of Housing and Community Development is currently (August 1987) exploring the development of a similar program. If consumer response to the Virginia plan is positive, private lenders may consider developing line-of-credit RM plans as well.

Insured RMs

Another promising development—but not yet an actual product—is the "insured" RM. Reverse mortgage insurance would provide lenders and borrowers with greater protection against the risks of RM lending and borrowing. It would encourage more lenders to offer RMs and provide greater security for borrowers.

Here is how it would work: The insurer would establish guidelines for the monthly advances (or line-of-credit withdrawals) that could be made in relation to your age, marital status, and home value. A corresponding premium would be charged on each RM and placed in an insurance account. Then, if you lived so long or your home appreciated so little that you would otherwise owe more than your home was worth, the insurance account would compensate the lender for some or all of the difference.

In this way, any lender could make an open-ended RM (that is, a RM with no repayment required until you die, move, or sell). And they could do so with less risk than some term RM lenders now face. The monthly advances you would receive would be less than the advances currently available through a shared appreciation RM. But you would retain more of the future appreciation in your home's value, and the possibility of having to pay a high effective rate of interest (see pages 00–00) would be eliminated.

In recent years, various proposals for a Federal Housing Administration (FHA) demonstration program on RM insurance have been passed separately by the United States Senate and the United States House of Representatives. At present (August 1987), the two houses have come very close to agreement on a common plan. If this program passes the Congress and becomes law, then an RM insurance demonstration program would probably begin within about a year of enactment. Up-to-date information on this proposal is available from AARP's Home Equity Information Center.

A few state governments and private insurance companies have shown some interest in the RM insurance concept. If an FHA demonstration is successful, then further development by others is likely. After all, it was FHA insurance in the 1930s that helped establish the 30-year fixed-rate "forward" mortgage and led to the creation of today's private mortgage insurance industry.

Sale Plans

In most cases when you sell your home, you move out and the buyer moves in. But with a home equity conversion (HEC) sale plan, you remain living in your home while receiving purchase payments from the buyer. These plans are much less generally available and usually more difficult to transact than HEC loan plans. The two basic types of HEC sale plans are the sale leaseback and the life estate.

In a sale leaseback, you sell your home to a buyer, who then leases (rents) it back to you.

Sale Leaseback

In a sale leaseback (SLB), you sell your home to a buyer, who then leases (rents) it back to you. You become a renter with a lifetime lease in the home you just sold. But the amount you now pay for rent each month is less than the monthly purchase payment you receive from the buyer. So you end up with more cash each month. In addition, you are no longer responsible for property taxes, insurance, major maintenance, or repairs.

The most difficult part of an SLB has always been finding a buyer willing to delay taking possession indefinitely. In the past, the tax advantages of owning rental property (income tax deductions for expenses and depreciation) have attracted few real estate investors to the residential SLB. And recent federal tax reform (1986) has made SLBs even less attractive from an investor's viewpoint. By lengthening the depreciation schedule, restricting the use of "paper losses," repealing favorable capital gains treatment, and reducing the tax rates, the new law has decreased the tax value of an SLB for most potential investors.

For the most part, this means the likeliest SLB buyers will probably fall into three general categories: 1) Investors who expect there to be substantial future appreciation in your property; 2) persons who are attracted to your home as a future retirement home for themselves and may view its purchase through an SLB as a retirement planning device; and 3) friends or members of your immediate or extended family who are motivated in part by wanting to help you remain in your home or to keep the home in the family. Such motivation will not be sufficient in itself, however, since the tax status of an SLB is dependent on its being a true business transaction entered on a for-profit basis.

Finding a buyer isn't the only difficult part of an SLB. You also need to retain an attorney who is at least familiar with—and preferably has completed a number of—SLB arrangements. Assuming you can find a buyer and an experienced attorney, you still have a lot of work to do. Now you must negotiate the terms of the SLB. You will normally have to reach agreement with the buyer on three related sets of issues: the lease, the sale, and the financing of the sale. Because the terms of these otherwise separate transactions are interrelated in an SLB, you need to reach a tentative agreement on the full package before you can see how well your overall interests will be served.

The terms of the lease are of particular importance to you. Your right to remain in your home for life will be best protected by a lease term that substantially exceeds your life expectancy or by a contract clause giving you the right to renew a shorter-term lease at your option indefinitely.

The rate of rent you will pay, and the ability of the new owner to raise the rent in the future, will be key factors in determining whether or not the SLB will meet your ongoing economic needs. In particular, you should compare the monthly rent you pay with the monthly purchase payments you receive from the buyer.

For example, if your rent is $500 and the buyer's monthly purchase payment to you is $750, then you will "net" $250 cash per month (in addition to no longer being responsible for taxes, insurance, maintenance, and repairs). However, if the rent goes up 5 percent per year, in five years it will be $638 (leaving you only $112 net cash per month) and in nine years it will be $775 (leaving you $25 short of being able to pay your rent with your monthly purchase payments).

On the other hand, you need to avoid a "bargain" rate of rent that might jeopardize the tax status of the transaction. Normally, a market rate monthly rent will equal anywhere from seven-tenths of a percent to 1 percent of a home's value. But this can vary greatly depending on local real estate conditions. You should compare any rent proposal with other rents being charged on similar properties in your area.

Additional lease items to be negotiated include the right to sublet the property and the responsibility for utility payments and minor maintenance and upkeep. The responsibility of the new owner for paying property taxes, special assessments, insurance, and major maintenance and repairs should be clearly spelled out in the lease agreement.

The purchase price for the home is a central element in SLB negotiations. It is important for tax purposes that the price fall within a market range. In other words, the price should generally reflect what your home would sell for on the open market if a leaseback provision were not part of the transaction. Normally, there isn't any one single market price, but rather a range of prices that willing buyers and willing sellers would agree upon. The price for your home

Table 14

Monthly Payment to a Seller on a Loan Made to a Buyer When Home Value = $70,000

At 9% Interest

		Monthly Payment to Seller When Loan Term =			
Downpayment	**Loan Principal**	**10 years**	**15 years**	**20 years**	**25 years**
$ 7,000	$63,000	$798	$639	$567	$529
10,500	59,500	753	603	535	499
14,000	56,000	709	568	504	470

At 10% Interest

		Monthly Payment to Seller When Loan Term =			
Downpayment	**Loan Principal**	**10 years**	**15 years**	**20 years**	**25 years**
7,000	63,000	832	677	608	572
10,500	59,500	786	639	574	541
14,000	56,000	740	602	540	509

At 11% Interest

		Monthly Payment to Seller When Loan Term =			
Downpayment	**Loan Principal**	**10 years**	**15 years**	**20 years**	**25 years**
7,000	63,000	868	716	650	617
10,500	59,500	820	676	614	583
14,000	56,000	771	636	578	549

should fall within that range. The exact price you settle on may depend to some degree on other factors in the overall agreement.

In most cases, the buyer will not pay you the full purchase price in cash. More typically, the buyer will make a cash downpayment and then pay you the remainder in monthly installments. Because you are in fact lending the buyer the remainder of the purchase price, the monthly installment payments to you will also include interest. As a lender, you will need to negotiate the terms of the loan you are making to the buyer. These terms include the downpayment amount, the interest rate, and the length of the loan term.

Taken together, the loan terms determine the amount of the monthly payment you receive from the buyer. Table 14 presents the monthly payments you would receive on a $70,000 home if the buyer made a down-payment of 10 percent, 15 percent, or 20 percent of the purchase price; if you charged 9 percent, 10 percent, or 11 percent interest on the loan; and if the loan term were 10, 15, 20, or 25 years. Table 15 presents the same information on a $100,000 home. As you can see, the payments are greater when the downpayment is lower, the interest rate higher, and the loan term shorter.

The amount of the downpayment and the length of the loan term are important factors in determining your long-term income security. What will you do when the loan term ends and you no longer receive a monthly payment from the buyer? How will you pay the rent? Should you make the loan term so long that you are very unlikely to outlive it? Or would that reduce the monthly loan payment too much?

Table 15

Monthly Payment to a Seller on a Loan Made to a Buyer When Home Value = $100,000

At 9% Interest

		Monthly Payment to Seller When Loan Term =			
Downpayment	**Loan Principal**	**10 years**	**15 years**	**20 years**	**25 years**
$10,000	$90,000	$1,140	$ 913	$810	$755
15,000	85,000	1,077	862	765	713
20,000	80,000	1,013	811	720	671

At 10% Interest

		Monthly Payment to Seller When Loan Term =			
Downpayment	**Loan Principal**	**10 years**	**15 years**	**20 years**	**25 years**
10,000	90,000	1,189	967	869	818
15,000	85,000	1,123	913	820	772
20,000	80,000	1,057	860	772	727

At 11% Interest

		Monthly Payment to Seller When Loan Term =			
Downpayment	**Loan Principal**	**10 years**	**15 years**	**20 years**	**25 years**
10,000	90,000	1,240	1,023	929	882
15,000	85,000	1,171	966	877	833
20,000	80,000	1,102	909	826	784

One solution to this set of questions is to use the downpayment to buy a "deferred annuity" contract from a life insurance company. This contract could be set up to provide you with monthly cash payments beginning in the month after you receive your last loan payment and continuing until your death. In this way, you could guarantee yourself a lifetime stream of monthly payments.

The cost of the annuity would depend on your age when you buy it and the date when its payments to you would begin. In other words, the length of the loan term, the amount of the downpayment, and the cost of the annuity are all interrelated. You need a loan amount (that is, home value minus downpayment) and a loan term that will produce a monthly loan payment to you that is sufficient to pay your rent and provide the extra monthly cash you need. But you also need a downpayment that is sufficient to purchase an annuity that will continue your monthly income after the loan term is over.

Additional issues are 1) the use of a variable interest rate on the loan, 2) the right of the buyer to sell the property, and 3) the right of the buyer to pay off the loan earlier than scheduled. These and other financial and legal issues are discussed in other publications listed at the back of this guide.

It should now be clear to you that a sale leaseback is a difficult and complex transaction. But it is not impossible. With a willing buyer and an experienced attorney, you have a reasonable opportunity to reach an agreement that will serve your interests.

Advantages. The attractiveness of an SLB versus HEC loan plan depends largely on your attitudes toward debt and homeownership. If you have strong feelings against indebtedness of any kind, and if you do not have strong feelings about retaining ownership of your home, then an SLB may be more suitable for you than an HEC loan.

Whereas you pay interest on most HEC loans, you earn interest on an SLB in two ways: on the loan you give the buyer, and on the annuity or other investment you buy with the downpayment. If your SLB is properly structured, you may also be able to exclude up to $125,000 of the capital gain you make on the sale of your home from your taxable income. Giving up some or all of the maintenance and repair activities that go along with homeownership may be attractive to you as well.

Some homeowners are interested in SLBs because they want to reduce uncertainty about the future. They are concerned about future increases in property taxes, insurance, and the cost of maintenance and repairs. Perhaps they are also pessimistic about—or simply wish no longer to be speculating in—the future appreciation potential of their properties. An SLB allows them to trade in these uncertainties for a firm, contractual schedule of future rent and purchase payments.

You are now dependent on a landlord for timely repairs, and on a borrower for timely loan payments.

Disadvantages. In addition to the time, effort, and difficulty involved in finding a buyer and an experienced SLB attorney, you also face the risks inherent in a very complex set of negotiations. If the agreement you reach with the buyer turns out to be defective in any of several ways, your future occupancy rights and income could be threatened. Even if your occupancy rights are well protected by the contract, you still lose some element of control when you give up ownership for "rentership." You are now dependent on a landlord for timely repairs and on a borrower for timely loan payments. You do earn interest with an SLB, but you no longer benefit from future increases in the value of your home.

If you are currently eligible for your state's property tax relief program(s),* you are likely to lose your eligibility or some of your benefits if you enter an SLB arrangement. You could lose eligibility if the program requires you to be a homeowner, or if your SLB income raises your total income above the program's income limits. You could lose benefits if renters are eligible for lower benefits than homeowners, or if benefits are lower for persons with higher incomes.

You must take particular care to consider the effect that SLB proceeds might have on benefits from Social Security, Supplemental Security Income (SSI), and Medicaid. The interest, annuity, and any nonexcludable capital gain income you receive could subject part of your Social Security benefits to taxation. The SSI and Medicaid programs—which provide benefits to low-income persons only—count any interest or annuity payments you receive as income for purposes of determining your eligibility and benefits. In addition, any downpayment or loan principal held beyond the month in which you receive it will be counted as a liquid resource and could affect your eligibility.

You remain the owner of your home until you die; then the buyer become the owner.

If you are considering an SLB and are currently receiving any of these benefits—or have reason to expect that you may otherwise be eligible for such benefits at some future time—you should carefully evaluate the effect an SLB might have on them. AARP's booklet, "Advising Older Homeowners on Home Equity Conversion: A Guide for Attorneys," provides detailed information on these issues.

*A brochure on the property tax relief program(s) in your state is available from AARP's Home Equity Information Center.

Availability. Although no one has yet put together a thriving business based solely on brokering SLBs, some real estate firms, attorneys, and certified public accountants (CPAs) have done enough of them to develop a modest expertise in the area. In some cases, these companies and individuals may be helpful in finding a buyer. Whether or not there is anyone in your community with SLB experience is something you would have to determine through personal research. Your local bar association, realtors association, or CPA association are probably the best places for you to begin your search. Materials listed at the back of this guide may also be helpful to you and your professional advisors in putting together an SLB transaction.

Life Estate

In this type of HEC sale plan, you remain the owner of your home until you die. What you sell is the right to ownership upon your death. In real estate law terms, you keep a "life estate" (that is, ownership until death), and you sell the "remainder interest" (that is, ownership that begins when you die). Because you retain ownership throughout your life, you do not pay rent. But you normally retain responsibility for property taxes, insurance, maintenance, and repairs.

Life estates and remainder interests do not offer the same tax advantages of an SLB. In particular, the seller may not take the one-time capital gains exclusion, and the buyer may not take deductions for expenses and depreciation. The buyer of a remainder interest, therefore, is unlikely to be a private, profit-seeking investor.

Instead, life estate plans are usually offered by nonprofit organizations such as hospitals, colleges, and universities. In most cases, however, these plans include some element of charitable donation; that is, they do not pay you full cash value for the remainder interest. Rather, they ask you to donate all or part of the value of the remainder interest to the nonprofit organization in exchange for gift tax deductions. Most homeowners interested in getting money from their homes would find little to gain in such plans, however. In most cases, their incomes would probably not be sufficient to take full or even partial advantage of the tax benefits.

There is at least one life estate plan that does pay full value for a remainder interest and is not based on tax benefits in any way. The Home Equity Living Plan (HELP) is financed by the City of Buffalo, New York and operated by a nonprofit organization incorporated specifically to run the program. In exchange for the remainder interest in your home, HELP provides two types of benefits: cash and noncash. The cash benefit is either a one-time lump sum settlement or a monthly cash payment for life. (Most HELP program participants have chosen the lump sum rather than the monthly installments.) The noncash benefits include major property repairs and maintenance plus payment of property taxes and insurance for as long as you live.

Since the HELP program was first offered in 1981, there has been only one effort to establish a similar program—and that effort has been discontinued. A program like HELP is a very ambitious undertaking for most nonprofit organizations. It is a complex program requiring a long-term organizational commitment, substantial financing, and significant expertise in real estate, marketing, property management, and financial administration.

The future availability of this type of plan in other areas is quite uncertain at best. One substantial nonprofit organization is currently exploring the creation of a model life estate program which—if successful—could spur other new developments. It is also possible that more individual transactions of this type might be completed with the aid of private attorneys. By and large, however, it is most likely that the "charitable donation" brand of life estate will continue to outnumber true HEC life estates for the foreseeable future.

The advantages and disadvantages of any life estate program depend largely on the specific details of the plan. When compared to a sale leaseback, the major advantages of a "noncharitable" life estate are that you retain ownership and control of your home and you are not dependent on a landlord or borrower.

On the other hand, you would most likely realize a lower monthly benefit from a life estate than from a sale leaseback. In many cases you would continue to be responsible for taxes, insurance, maintenance, and repairs with a life estate. You might also have to pay capital gains taxes on your sale of a remainder interest, and you could lose eligibility for some public benefit programs (see AARP's booklet, "Advising Older Homeowners on Home Equity Conversion: A Guide for Attorneys"). Finally, a life estate could be very costly to your estate if you die soon after the sale of the remainder interest.

Appendix A

Summary of Home Equity Conversion Plans

HEC Plan	Availability*	Eligibility Limited by Income?
Deferred Payment Loan	Generally offered by local nonprofit or government agencies on housing or community development	Yes
Property Tax Deferral	Available in all or parts of CA, CO, CT, FL, GA, IL, IA, MA, NH, OR, TN, TX, UT, VA, WA, WI; contact local tax collector	Yes, in most cases
Term Reverse Mortgage (RM)	Available statewide in CT, MA, and NJ; most parts of CA; Pima County, AZ; Richmond, IN; Minneapolis-St. Paul, MN; Nassau and Suffolk Counties, NY; Madison and Milwaukee, WI	Depends on program
Split Term RM	Available in CT and RI through state housing finance agency	Yes
Shared Appreciation RM	Available in CT, MD, NJ, OH, and PA through American Homestead Mortgage Corporation of Mount Laurel, NJ	No
Line-of-Credit RM	Expected to become available in VA and MD through state housing development agencies	Yes
Sale Leaseback	Generally, seller must find buyer and retain attorney to complete transaction	No
Life Estate	Available only in Buffalo, NY through Home Equity Living Plans, Inc.	Yes

HEC Plan	Keep Ownership and Go Into Debt?
Deferred Payment Loan	Yes, both
Property Tax Deferral	Yes, both
Term Reverse Mortgage (RM)	Yes, both
Split Term RM	Yes, both
Shared Appreciation RM	Yes, both
Line-of-Credit RM	Yes, both
Sale Leaseback	No, neither
Life Estate	Keep ownership until death; no debt

*As of August 1987.

Appendix A, Summary of Home Equity Conversion Plans, continued

Benefits	HEC Plan	Costs		
		Interest Rate	Repayment Required	Other Costs
One-time lump-sum of cash for repairing or improving home	Deferred Payment Loan	Generally no interest or a very low rate	At death, sale, or move-out	**
Annual loan for paying property taxes	Property Tax Deferral	Generally 6% or 8% fixed by law	At death, sale, or move-out	**
Monthly cash advance for fixed term of years; term selected by borrower (generally limited to from 3 to 12 years); large monthly advances possible for short loan terms	Term Reverse Mortgage (RM)	Generally a market rate	On a fixed date, when monthly cash advances stop	**
Monthly cash advance for fixed term of years (in CT must be 10 years, in RI must be 10, 15, or 20 years)	Split Term RM	Below-market (currently 7%)	At death, sale, or move-out	**
Monthly cash advance guaranteed for as long as borrower remains living in home	Shared Appreciation RM	Fixed rate (has been 12.1% APR since program began in 1984)	At death, sale, or move-out	**Borrower must also pay some percentage of future increases in home value
Flexible withdrawals selected by borrower within program limits	Line-of-Credit RM	Below-market rate	At death, sale, or move-out	**
Cash downpayment, monthly purchase payments from buyer, optional annuity payments for life beginning after purchase payments stop; no longer responsible for taxes, insurance, maintenance, and repairs	Sale Leaseback	(Not applicable)	(Not applicable)	**Seller must transfer ownership and pay market rate of rent to buyer
One-time lump-sum of cash or monthly cash advances for life; necessary property rehabilitation; no longer responsible for taxes, insurance, maintenance, and repairs	Life Estate	(Not applicable)	(Not applicable)	**Seller must transfer ownership to buyer at death

**Fees and other charges vary considerably from program to program. In general, the lowest costs are found in government programs such as deferred payment loans, property tax deferral, and the HELP program. Many of these programs have no application fee or closing costs. Reverse mortgages normally require closing costs (for example, title insurance, appraisal, recording fees, termite certification) and—when private lenders are making the loan—a loan fee (usually 1 or 2 percent of the loan amount or home value). These charges can normally be paid with an initial lump sum advance from the RM. Sale leasebacks generally require fees for professional services provided by realtors, attorneys, or accountants.

Appendix B

Toward a Better Understanding of Home Equity Loans and Home Equity Conversion

A variety of mechanisms are rapidly emerging in the financial marketplace to provide homeowners with a readily accessible source of cash by using the equity in their homes as collateral. These plans are known as HOME EQUITY LOANS or HOME EQUITY CREDIT LINES. Emerging less rapidly are mechanisms that are similar in name, including HOME EQUITY CONVERSIONS or REVERSE MORTGAGES.

The list below is a brief summary of the major features of these mechanisms. It is important to note that specific plan features vary among lending institutions. YOU SHOULD FULLY EXPLORE THE TERMS OF ANY PLAN YOU ARE CONSIDERING IN ADVANCE OF THE TRANSACTION.

	Home Equity Loans/Credit Lines or Second Mortgages	***Home Equity Conversion/Reverse Mortgages***
Availability	These are widely available through many savings and loans, banks, mortgage companies and local loan companies.	These are available through only a few banks, savings and loans, state housing finance agencies and mortgage companies.
Eligibility	Criteria include homeownership and ability to repay the loan from current income. (The latter requirement disqualifies many older persons.)	Criteria include homeownership, freedom (or nearly so) from mortgage debt; and an age minimum (often 62 and over). Ownership in a cooperative does not apply.
Terms	The lender will provide a lump sum or a *line of credit* for a percentage of the equity in the home. Often, there is a minimum withdrawal amount.	Based on the equity in the home, the lender will provide periodic cash payments or a line of credit for a specified period or until the home is sold.
Repayment	As with conventional loans, repayment begins immediately upon withdrawal of cash. In some situations, only interest must be repaid on a monthly basis. Often, the lender establishes a balloon payment in 7–10 years.	Repayment of the loan and interest is not required until an agreed-upon future date (5–20 years) or until the homeowner dies or sells the home.
Interest Rates	Rates vary widely among lenders. The rate is often variable, or fixed for only an initial period. Interest rates have been as low as 2.9 percent and as high as 18 percent. Interest is compounded.	Generally, rates are fixed, ranging from 8 percent to 12.1 percent, depending on the lender. Interest is compounded.
Fees	There is often an application fee, closing costs and a service charge for maintaining the line of credit.	There are closing costs and a loan application fee.
Retention of Title	The homeowner retains title.	The homeowner retains title.

Borrower Default	The lien the lender has placed on the home provides the lender the right to foreclose on the home at any time and sell the home to repay the loan.	The lien the lender has placed on the home provides the lender the right to foreclose on the home and sell the loan. This cannot occur until the loan is due, at which point the borrower is likely to sell the home to repay the loan.
Interest Deduct-ibility	The interest paid on a home equity loan is deductible if the proceeds are used for medical bills, educational expenses or home improvements.	The interest is not deductible until it is paid, i.e. when the loan is repaid.
Use of Funds	Funds can be used at the discretion of the borrower, except in a few states with homestead exemptions that limit use to home repairs/improvements.	Funds can be used at the discretion of the borrower.

For More Information . . .

AARP Home Equity Information Center
Consumer Affairs Section
American Association of Retired Persons
1909 K Street, N.W.
Washington, DC 20049

Materials:

- Advising Older Homeowners on Home Equity Conversion: A Guide for Attorneys (D 12565)
- Home Equity Conversion for the Elderly: An Analysis for Lenders (D 12504)
- The Unique Asset: A Home Equity Conversion Guide for Financial Advisors (D 12490)

American Bar Association
Commission on Legal Problems of the Elderly
1800 M Street, N.W.
Washington, DC 20036
(202) 331-2297

Materials:

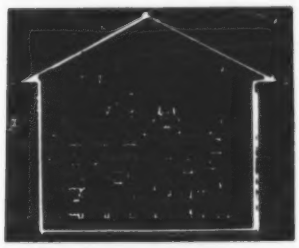
- Attorney's Guide to Home Equity Conversion
- Brochure on Home Equity Conversion

National Center for Home Equity Conversion
110 East Main Street
Madison, WI 53703
(608) 256-2111

Materials:

- A Financial Guide to the Individual Reverse Mortgage Account (IRMA)
- Sale Leaseback Guide and Model Documents
- Deferred Payment Loans for Home Repairs and Improvements: A Program Development and Operations Handbook

A Publication of the
Home Equity Information Center



Consumer Affairs Section
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